Hearing of François Villeroy de Galhau,

Governor of the Banque de France,

before the Finance Committee and

the European Affairs Committee of the National Assembly

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Mr President, Madam President, Mr Rapporteur-General, ladies and gentlemen,

I would like to thank you for welcoming me this afternoon, virtually and exceptionally, before the two Committees. The Banque de France regularly "reports" to you, the elected representatives of the Nation, but this task is even more essential during this unprecedented crisis. I will begin with a few words on the economic situation; I will then address the strong mobilisation of the Banque de France and the ECB during the crisis, before outlining the conditions for economic recovery.

I. The economic situation during the lockdown

As regards the economic effects of the lockdown, we are converging towards a loss of activity of about one third. The figure for the first quarter published by INSEE last Thursday confirms this order of magnitude, in line with the -6% we had forecast as early as 8 April: -5.8% of GDP over three months corresponding to -32% over a fortnight in March. These effects will be mechanically more pronounced in the second quarter because they will be longer-lasting. We will estimate them for April in our next monthly business survey to be published on 12 May. However, it is still too early for us to forecast the recession in 2020 and the expected rebound in 2021.

A word on the first comparison with other European economies, which should be taken with much caution: all have slowed significantly, but France more so than Germany; even Spain and Italy have seen their construction sector less affected than in France, and recourse to short-time work appears to be much stronger in our country, with the most generous compensation package. There may be several useful lessons to be learned for exiting the lockdown; it is essential for our economic health that France now returns to work at full capacity, while of course ensuring the protection of all employees.

II. The mobilisation of the Banque de France and the ECB during the crisis

During this crisis, the Banque de France immediately focused its activities on five key fronts: (i) supporting households in difficulty as well as VSEs and SMEs through the Bank's network across France – I would like to stress the essential role played by Credit Mediation, under the aegis of the Banque de France, in each *département* – the number of daily requests for mediation has reached 200, the vast majority of which are from VSEs: in one week, this figure is higher than in the whole of last year, but it is less than 1.5% of the requests for State-guaranteed loans; (ii) responding to needs for cash – we have not experienced any supply problems; (iii) economic analysis and monetary policy; (iv) careful monitoring of the markets; (v) and supervision of the financial soundness of banks and insurance companies via the ACPR.

We are also on the front line of the European response, that of the ECB Governing Council. It was rapid – within six days, as early as 12 and 18 March – and massive – in terms of potential liquidity for businesses and governments. And, so far, it has been effective in financing the sharp increase in corporate loans (+7.5% in one year in France at end-March) and stabilising their cost. But, as we just said last Thursday, we will be as flexible as required – in particular to avoid the fragmentation of the euro area, with unjustified interest rate increases in some countries; and we will be as innovative as necessary regarding instruments. Our Governing Council took note yesterday of the judgement by the German Federal Constitutional Court in Karlsruhe: as the Court of Justice of the European Union (CJEU) has said, our past actions are indeed proportionate to our mandate, and our determination for the future to deliver on that mandate is total.

Allow me to express a broader consideration, at a time when some voices are being raised in various quarters to call into question the independence of the central bank and its mandate focused on price stability. Criticising these two pillars seems to me not only unnecessary, but also dangerous.

Unnecessary because the ECB has demonstrated its ability to innovate and to act swiftly while remaining within its mandate. But it is also dangerous because these two pillars, which are enshrined in the democratically voted Treaty, are the legal basis for our action. Even more so, they are the basis for Europeans' confidence in their currency. We cannot cancel the public debts we hold today, neither legally, nor from a "fiduciary" point of view: a suspicion of fiscal dominance would cause mistrust in the currency. Independence and price stability do in no way stand in the way of powerful action by the ECB, on the contrary. Our definition of price stability is an inflation rate below but close to 2% over the medium term, and this target is a symmetric target, not a ceiling. In comparison, inflation is currently low: it stands at 0.4% in the euro area and 0.5% in France; our estimate is that it should remain below 1% overall, contrary to the fears of our fellow citizens, who have seen a temporary rise in food prices. The current shock is disinflationary, with low oil prices and, more broadly, demand that is likely to recover more slowly than supply. And so, in the very name of our mandate, we will be able to go further, and we will most likely have to go further, and thus support the recovery through low interest rates and abundant liquidity for a long time.

III. The conditions for a recovery: a "triangle of reassurances"

Initial hopes were for a rapid "V-shaped" recovery. It is clear today that it will take time, and that, beyond the Act 1 emergency phase, patient and selective measures will be needed to guide the recovery. Getting back onto a better economic footing will require what I call a "triangle of reassurances": household confidence, the solvency of businesses and the sustainability of public debt.

1/ Unfortunately, some households have been made more vulnerable by the crisis, and it is crucial that they be helped through solidarity. But on the whole, household consumption will have fallen to a much greater extent than household income during this lockdown, leading to a significant build-up of "forced savings" – at least EUR 15 billion in March, and probably EUR 60 billion by the end of May. Going forward, these reserves will need to be converted rapidly into spending and hence growth. To ensure economic confidence, it will be preferable in the short-term to avoid the recessionary impact of higher household taxes.

More than purchasing power, therefore, the priority regarding households is their confidence. If a tax measure for all households were to be envisaged, it would be better to focus on temporary and targeted incentives to encourage households to consume their savings.

2/ For businesses and the self-employed, the exit from lockdown will potentially prove risky. Despite major liquidity support, the irrecoverable losses in revenue will have damaged their solvency. Their overall debt has already increased sharply, by 2% or EUR 32 billion in March alone.

Support for businesses will therefore need to be redirected in part from the loans seen in Act 1 towards quasi-equity. But to avoid any windfall effects or ruinous failures, the scheme will have to be both efficient and selective. Act 1 was broadspread; the next acts will need to set priorities. Another idea would be to allow companies to offset their 2020 losses immediately against their corporation tax for 2019 and previous years. Those sectors subject to a long-term shutdown will have to be provided with ad-hoc support. Among other measures, the Ministry of the Economy has proposed injecting public capital into listed companies, provided they are viable. For SMEs, however, a system of crowdlending will be more appropriate.

One interesting suggestion from several economists is that we should set up a temporary European business recapitalisation fund, which could be linked to the EIB. This would have the dual advantage of (i) levelling the playing field between countries, by ensuring that those least in debt today do not provide more help to their own national companies; and (ii) potentially bringing Northern and Southern Europe into agreement, so that we can end the somewhat sterile debate over loans and subsidies.

3/ The cushioning mechanism put in place by the government is playing a massive role, which is good news: it is absorbing around 60% of the current shock, with the balance mainly being absorbed by companies and, to a more marginal extent – around 5% – by employees. The price of this mechanism is that public debt will have increased by at least 17 percentage points to 115% of GDP by end-2020. The post-lockdown period will therefore be a delicate balancing act for public finances, between fostering a rapid recovery and ensuring long-term sustainability. Supporting the recovery could mean dealing with the debt inherited from the crisis separately, by partially “ring-fencing” it – the only advantage of which would be to push back its repayment further into the future. Conversely, for future debt associated with the financing of the recovery, the idea of pooling it with more financially sound countries was what inspired the post-war Marshall Plan. The French proposal for a common European fund to finance new investment programmes, for the climate for example, would be the best way of showing European solidarity.

But there is no magic bullet: in the long run, this debt will need to be financed through growth and through our work – which is why a balance needs to be found in fiscal policy. It is up to the government and parliament to make the necessary adjustments, but I would just like to raise two points:

- In the short run, it is normal – and even desirable – to have a high deficit, in order to counter the recession. But we need to prioritise spending that is temporary, and even reversible debt – such as investment in firms’ quasi-equity – and avoid permanent spending or tax cuts which would place an unjustified burden on the post-crisis period. Again in the short run, we will need to avoid tightening fiscal policy too soon into the recovery.
- Conversely, in the medium term, once growth is firmly established, we will need to come back to a more selective fiscal policy, and to more efficient public spending. This is the structural challenge that France faces, while at the same time prioritising investment in the future, which means in education, professional training and a more qualified workforce. In the four years from 2016 to 2019, we notched up some impressive collective successes in terms of employment; we will need to pick up where we left off. In this way, I hope we will be able to overcome this harsh challenge for our country.

Thank you for your attention and I am happy to answer any questions.